



**FINAL MONTENEGRO PROGRAM REPORT
TO
U.S. AGENCY FOR INTERNATIONAL
DEVELOPMENT**



**Cooperative Agreement NIS-A-00-97-00026-00
August 1999 – June 2002
\$4,400,000**

***Enterprise Restructuring and Private-Sector Development in
Montenegro***

September 2002

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A. INTRODUCTION

This is the final program report for activities in Montenegro under USAID Cooperative Agreement NIS-A-97-00026-00 (hereafter referred to as the “Program”). The initial award was signed between USAID and the University of Delaware (UD) on May 31, 1997 for a program in the war-affected areas of Croatia. Subsequently, modifications to the cooperative agreement were made to add economic development activities in Montenegro. The report provides a review of activities and results over the duration of the Program in Montenegro only, and was prepared by FLAG International, LLC (FI). Since January 1, 2001, FI has performed all services to fulfill obligations within the Program scope of work under a Cooperative Agreement with the University of Delaware.

As with many multi-year projects, our scope of work was periodically amended to reflect changing conditions and opportunities, new strategic frameworks within the USAID Missions, and improved approaches to strengthening small and medium-sized enterprises (SMEs) based on best practices and lessons learned. The following report describes Program activities, including technical assistance strategies and results achieved. A summary is also provided to document lessons learned and recommendations for continued activities.

In addition to UD, the prime award recipient, two partner organizations recruited volunteer executives and advisors to provide technical assistance: International Executive Service Corps (IESC) and Agricultural Cooperative Development International/Volunteers in Overseas Cooperative Assistance (ACDI/VOCA).

B. PROJECT BACKGROUND

The original Cooperative Agreement was signed between USAID and the University of Delaware (UD) on May 31, 1997. The original Agreement was modified 13 times. Activities in Montenegro were extended to July 31, 2002, with approval of modification 13. Below, we highlight the modifications to the Cooperative Agreement related to Montenegro activities.

Modification 04

The purpose of modification 04, in June 1999, was to incorporate a supplemental program description and revised budget to reflect program activities in Montenegro. This was a no-cost extension.

Modification 05

The purpose of this modification, in September 1999, was to provide a no-cost extension to the Montenegro activities included in the agreement by modification 04.

Modification 08

The purpose of modification 08, in June 2000, was to provide incremental funding for activities in Montenegro.

Modification 09

The purpose of modification 09, in August 2000, was to provide incremental funding for activities in Montenegro.

Modification 11

The purpose of modification 11, in May 2001, was to add incremental funding for program activities in Montenegro.

Modification 12

The purpose of modification 12, in December 2001, was to provide a no-cost extension to activities in Montenegro.

Modification 13

The purpose of modification 13, in March 2001, was to provide a no-cost extension to activities in Montenegro.

C. ACTIVITIES AND RESULTS

C.1 Strategy and Program Implementation

At the time of project design and award, Montenegro was undergoing a social upheaval in the wake of NATO bombing and resistance to the rule of Slobodan Milosevic. The Program was part of the US strategy to support the transition of Montenegro to open, democratic rule and the beginning of open market competition in the economy. Initially the program was meant to review several economic prospects for Montenegro. Later, program objectives were added to provide support to the government in privatization and pre-privatization activities, and direct technical assistance to businesses in Montenegro.

C.2 Program Components

The Program went through several phases beginning with a review of the potential of appliance manufacturer OBOD, in Cetinje, a review of two large wood processors and an overview of tourism potential in Montenegro. Subsequently, program activities added were assistance to the Ministry of Tourism in privatizing tourism assets, direct technical assistance to the private SME community, providing turnaround management to aluminium producer Kombinat Aluminijuma Podgorica (KAP), and a viability study of selected SMEs that had recently undergone partial or full privatization.

a. OBOD:

FLAG International worked in OBOD from August 1999 to June 2000. The purpose of the project was to provide technical assistance and consulting services in order to restart production and transform the firm into a profit-oriented company.

We brought in two-full time consultants (one local and one American) from outside FLAG to work in production areas while we worked to improve financial and marketing management. We also brought in five part-time consultants providing additional expertise specific to the industry.

In the brief period we were able to work at OBOD, we provided consolidated financial statements that conformed to GAAP for the firm's 14 separate business units. These units previously were not networked and seemed to have financial management using 14 different sets of accounting rules. Using these restated financials, we attempted to train local staff in the responsibilities of accounting and financial managers while preparing financial projections. At the same time, and in coordination with these activities, we made recommendations to management on consolidating these 14 business units into a coordinated whole. This was part of a detailed strategic and marketing plan for the company as a whole. On the marketing side, in addition to the marketing plan mentioned above, we re-established relations with eight of OBOD's local distributors, performed research in all of OBOD's former markets in Yugoslavia, and, using this, we developed sales forecasts, and recommended design and production changes to meet the potential market.

Further, we prepared a report on OBOD's current situation in which we made specific recommendations for restructuring the labor force, re-engineering the production processes, and reorganizing the management structure. This report was presented, in the end, to the Government of Montenegro, OBOD's Board of Directors, the firm's management team and representatives of OBOD's union.

b. Tourism:

Tourism activities began as a review of tourism potential in Montenegro with no technical assistance implied. When program activities ended at OBOD, and after a general review of tourism assets in Montenegro, USAID asked us to support the Minister of Tourism in preparing properties for privatization. This work involved one full-time local dedicate to this portion of the Program, one long-term, part-time expatriate consultant, and several short-term expatriate assignments. When the scope of this activity changed, we intensified our review of tourism assets from one of a physical nature, exploring the amenities provided at different sites, restaurant activities, accommodation size and structure to exploring financial and marketing management, and we began providing each asset with a review based on an international rating system.

After this was complete, we began providing technical assistance to the Ministry of Tourism itself to enable the sale of these assets to international bidders. The first step was to challenge the expectations of the various stakeholders involved given the realities of the tourism assets' condition, the amenities provided, and the relative stature of Yugoslavia as a tourist destination. We began providing valuations of the various assets which was a contentious process with the respective property owners and managers who were mostly political appointees but had a personal stake in the potential sale of the assets. As a result, we proposed establishing an Asset Management Team comprised of local and expatriate experts to oversee the valuation, negotiation and sales processes. This idea was rejected by USAID and the plan was moved forward to sell the assets directly from their respective management companies using the Ministry of Tourism as a marketing vehicle. This culminated in a conference in May 2001 that attracted over 100 industry representatives to see the properties and presentations.

The final step in our tourism activities came in early 2002 as we completed a full review of the National Park System in Montenegro. This work was coordinated with our SME development activities as we looked at the possibilities for private companies to assume many of the roles now underperformed by the state such as lodging, restaurants, and recreational activities. We made numerous recommendations along these lines and provided the business community with many ideas for entrepreneurship should the government open up the parks to private management of these activities. In addition, we made numerous recommendations to improve the morale of people working in the national parks, increase the marketing of Montenegro's natural wealth, and coordinating the national park system with the beach tourism for which it is more famously known.

c. SME:

Financial Management Training and Technical Assistance

Financial management training and technical assistance was accomplished in several ways. First, firms were provided assistance in implementing sound accounting practices. Through direct assistance to management, we assisted firms in the principles of accountability, transparency and compliance to provide them with additional tools for oversight of their firms, a flatter management structure and a firm legal footing.

Operations Management

Operations management consisted of, primarily, the support of US volunteer executives to implement training in production and logistics management. Volunteer executives helped firms to develop their supply chains, efficiencies, distribution and transportation structures to allow firms to compete with local and international firms, and provide better partnering opportunities for foreign businesses.

Marketing Assistance and Marketing Management

Marketing assistance and marketing management were implemented through the development of marketing surveys with support from volunteer executives and local consultants. Once firms became viable in terms of core management (finance and operations), they were better prepared to bring products to market. Marketing surveys provided this knowledge and enabled assisted firms to increase revenues, decrease receivables and establish products in markets unknown or unavailable to them at the time.

Improving Access to Capital

As firms became more capable at managing products and assets, they were better positioned to develop relationships with sources of commercial finance and to receive commercial financing for future growth and expansion. We continued to update our existing database of financing sources and developed relationships with these financial institutions. As assisted firms developed, the relationship between FLAG and these financial institutions facilitated client access to capital, allowed relationships to develop between the institutions and the firms, and helped both grow.

Impact and Sustainability

The broad range of services provided by FLAG required partnering with domestic institutions to jointly conduct training. Our strategy for the sustainability of firm-level assistance (technical and management training for SMEs) included two complementary types of activities to achieve impact. First, by providing direct assistance to SME owners and managers, our business clients were trained and continue to apply the new concepts and approaches. Second, by “training the trainers” of local partner institutions, developing seminar material and a fee-for-service component in conjunction with these partners, we had a long-term impact on the local institutions’ ability to champion these new concepts. These local partners continue to disseminate the new concepts to a broader audience.

b. Regional Trade Facilitation

Facilitating linkages and trade between companies in Montenegro, as well as other parts of Yugoslavia, and foreign markets required creativity in local professional staff. We facilitated linkages between companies in Montenegro, and between companies in the former Yugoslav republics. To accomplish this, trade facilitation activities consisted of three areas:

- Global Technology Network (GTN);
- FLAG Marketing Database;
- Training and Technical Assistance

Global Technology Network (GTN)

The Global Technology Network (GTN) assisted Croatian small and medium-sized firms seeking access to US and regional markets. GTN partners in Macedonia, Croatia, Bulgaria and Romania were linked with an internet-based communications and trade lead system that facilitated collaboration throughout the region. GTN was operated by USAID’s Office of Business Development and FLAG was the initial local partner for the GTN system in Montenegro.

In 2000, we also joined a new USAID Office of Business Development initiative to expand a new electronic commerce system, Global Technology Network (GTN). GTN targeted small and medium-sized enterprises seeking access to US and regional markets. GTN partners in Macedonia, Bulgaria, Croatia and Romania were linked together through an internet-based communications and trade lead system that facilitated collaboration throughout the region.

Post-privatization

Our activities with the former state-owned SMEs began in March 2002. This project was for the review of a select group of 16 SMEs that had recently gone through mass voucher privatization to test their viability as private-sector concerns. While some technical assistance was provided in this process, it was minimal and would not be sustainable without longer-term, on-site technical assistance.

d. KAP:

At the end of 2000, we were asked to look into assistance possibilities at KAP which constituted nearly 50% of Montenegro’s GDP and close to 70% of its export earnings. The

plant was almost 30 years old at the time, had not had an annual profit in 10 years, and had costs that increased annually as a percentage of revenues. Beginning in January 2001, we began work at KAP with a management team of three individuals with combined experience of over 90 years in the industry. The management team consisted of a CEO, an operations manager, and a financial manager, and was mandated to bring the plant to break-even by cutting costs, increasing production, reorganizing the firm, and training viable managers, or any mix of the above as needed. The mandate was for one year and the Government of Montenegro was to prepare for the privatization of the plant during this period.

We dedicated the first quarter of the year to an analysis of operations and setting the plans for operational improvements. However, this period was almost solely dedicated to putting a Debt Restructuring Agreement (DRA) in place. In April, this DRA was completed and signed by KAP, the Government of Montenegro, creditors, and other stakeholders. It introduced a series of sweeping changes to KAP's debt problems, established a plan for introducing new accounting standards, provided a working capital facility, and relieved KAP of burdensome repayments. Previously, there were no cash management at KAP and no cash forecasts. Compliance with the DRA required:

- Preparation of monthly budgets and forecasts.
- Monthly preparation of a rolling 3-month cash forecast.
- Constant liaison with the bank designated to control the process (and a stakeholder itself) to ensure correct processing and reporting of all payments, particularly those that pass through the local agent bank.
- Monitoring and reporting of the Excess Revenue stream.
- Constant monitoring of the cash position to ensure proper notice is given for all draw downs, etc.; and,
- Preparation of all reports under the DRA.

To meet compliance, we hired three cost accountants to work in different areas of the plant and provided a link to the financial managers. We also recruited two consultants to put in place cost and financial accounting systems that would serve the short-term needs of KAP. The long-term needs would require much more investment than KAP could reasonably assume during our term.

Additionally, we created and trained a procurement team that had control over procurement contracts at the plant and introduced modern bidding practices to increase competition transparently for any supply contracts at the plant. This cut off old suppliers who were not able to compete, introduced some international players to KAP's operations, and improved the inputs while reducing the cost of these inputs.

Operationally, we reengineered their production by rearranging the work force to make sure that everyone was doing something which increased morale and helped in many areas of general maintenance that had been overlooked for so long. We also assisted in the repair and maintenance of equipment that workers and management at KAP had concluded had no useable life remaining. Further, we increased amperage at the plant, put more pots on line, and assisted the anode supplier in increasing its quality.

C. 3 Results Achieved

a. OBOD

Due to an intransigent union, weak management, and a precarious economic situation in Yugoslavia, we were unable to effect lasting change at OBOD. We began successfully to change marketing and financial management but were unable to enforce needed changes to the labor force and, in the end, the management relented to the Union and many of our changes were rolled back or recommendations set aside. At this point, we ended our involvement with OBOD.

b. Tourism

Unlike other areas of our Program, no definite goals or targets were set for these activities. However, in the process of reviewing the tourism assets, presenting seminars, and providing technical assistance to the Ministry, we were able to assemble three tenders for hotels that were published internationally resulting in the sale of one asset to an international tourism operator, designed accounting systems for several tourism management companies that allow them to track costs and results, introduced modern marketing principles to property management and the Government, and introduced the Ministry to several international firms involved in international tourism. As noted above, our conference was attended by more than 100 individuals from the international tourism industry and through this we helped introduce Montenegro as a separate tourism destination from other markets in the Adriatic and an individual market within Yugoslavia. We also promoted the idea that Montenegro should be sold as a year-around tourist destination for internationals rather than just beach tourism with the mountains and parks reserved for those within the former Yugoslavia. We also introduced the management operators and the Ministry to the notion that tourism assets will be difficult to sell individually and must be part of a package including outside amenities and attractions to encourage the development of regional tourism bodies that can incorporate and develop all the available assets and integrate them as a package.

c. SME

Early in the Program, no results and indicators were established for the work of developing the SME sector. Later in the Program, we established these to provide for an increase in revenues and employment. While we did make gains in revenues (13%), employment gains were not successful since the business laws on labor are such that companies refuse to report the number of employees or refuse to hire anyone due to the excessive incremental cost of hiring even one person, and some of the companies were oversized and needed to reduce staffing. These costs are tied up in old-style social welfare taxation systems that provide more to the state coffers than to the individuals themselves. Overall, we assisted 286 firms (65 who had direct, sustained technical assistance) by providing trade linkages, business/marketing/strategic plans (7/2/6 plans, respectively), and direct technical assistance in areas of marketing, financial management, accounting, operations, business planning and trade.

While we did provide a limited number of business plans, we promoted the use of fee-for-service local firms that provide business plans as much as possible. In any event, business plans over USD 10,000 were rarely seen to be financed by the local financial institutions due to the perceived risk of lending to private entities. While most of the banking sector stated

that they didn't have adequate risk capital for lending, we found out that the capital existed but the banks did not have the capacity to analyze businesses and determine risks. Instead, they held on to old practices which involved lending only through personal connections or government connections, effectively shutting out newcomers to the market, or those with no personal ties.

We also created and presented a number of seminars (15) to the business community in areas of financial management, accounting, financial analysis, business planning and marketing. These seminars were attended by around 300 people from businesses, government ministries related to the economic sectors, and students. The number is purposefully small as we tried to limit the attendees to those who will have the most direct benefit from the training and to encourage discussions by business owners and managers.

For the review of the 16 selected SMEs, we presented reports on 15 of the 16 companies. One firm never responded to our queries and never allowed us access. Of the remaining 15 firms, we determined that 5 had a viable chance of success given a number of areas of assistance both macroeconomic and micro. Three of the firms needed further review as there was not enough available information provided in the short timeframe of the project to make determinate findings. We recommended that the remaining firms should no longer be provided any assistance from the government and should be allowed to pass into bankruptcy where the creditors and owners could dispose of the assets in a way to best provide for these stakeholders.

We provided all of the above through the use of 46 international volunteers and consultants, local employees, and 16 local consultants.

d. KAP

By the end of the year at KAP, it was clear that the plant had undergone dramatic changes. By trying to make sure that everyone was employed in some fashion, using previously idle workers, the physical appearance of the plant was cleaner, more organized, had little or no scrap laying around, and no workers with nothing to do. This increased morale and helped improve workers' attentiveness to their daily activities, which, in turn, meant less loss to the plant in terms of man-hours, supplies, and scrap. The end result of operational improvements is as follows, year-to-year, 2000-2001:

- 47.90% increase in operational pots
- 14.72% increase in liquid metal transfers
- 21.57% increase in alumina production, a record for the plant
- 1.05% decrease in energy consumption
- 9.67% decrease in cost per metric ton

The end result of our work in total at KAP resulted in KAP having its highest revenues in its history. The results would have been much better if various macroeconomic forces were controlled such as excess labor and the benefits and taxation for the labor force. Labor costs at KAP are, contractually, 3-4 times higher than the average wage in Montenegro. One force beyond the control of any management team was the international market price for aluminum which dropped almost 12% by the end of 2001.

C. 4 Lessons Learned and Continued Activities Needed

The past 35 months provided an opportunity to identify ways in which the original Program could be strengthened. Many of the issues discussed below have been presented to USAID in quarterly reports during the life of the Program, or discussed at USAID planning meetings. This section attempts to provide not only lessons learned but also recommendations for continued assistance to SMEs in the war-affected areas of Croatia.

Management Lessons and Recommendations

Sustainability of our technical assistance services was not an issue of primary concern at the beginning of the project. Instead, assisting in stabilizing the economic situation in a time of transition was the primary concern. With modification 11, we began shifting emphasis toward building sustainability for our services, and the sustainability of local business support organizations and partner institutions into the design of the program.

We have noted an increased interest among foreign donors to concentrate on economic development and to provide business support programs. This was a welcome relief from the past, when most organizations concentrated resources on rebuilding infrastructure and providing emergency relief donations to refugees. Future donor programs need to be coordinated closely with local communities to leverage resources, limit duplication of activities, and maximize the coordination of economic development activities in each region.

Firm-Level Assistance Lessons and Recommendations

The Program of providing technical assistance to SME clients has revealed a strong interest among clients in four key areas: financial management, operations management, marketing and marketing management, and improved access to capital. Since clients have demanded more technical assistance in these areas, the final phase of the program concentrated on these areas.

We experienced challenges and even difficulty following up on such a large number of business clients in these areas receiving one-on-one technical assistance and consulting from US volunteers and the resident expatriate personnel. Given the small number of personnel involved and the large number of companies demanding these services, we reduced the number of active business clients and conducted more targeted seminar training to a broader audience of managers and owners. The result was continued high-quality assistance to clients that demonstrated a potential for creating jobs and training for a larger number of managers and owners that would otherwise not receive such assistance. Start-up companies and SMEs tend to employ relatively small numbers (less than 20). The cost/benefit of one-on-one consulting for companies with few employees has shown moderate results in terms of creating jobs. The goal of expanding seminar and outreach training to a larger audience is to create jobs at a higher rate by broadening the impact of the training and technical assistance program.

Achieving sustainability for our business services was a difficult but necessary objective. We did not implement a fee-for-service component because of the poor economic conditions resulting from the recent conflict and transition to a market economy. The geographical limitation of working in such a small economy also limited the likelihood of working with companies capable of paying fees for business services. This is beginning to change but has

a long road to follow before businesses realize the benefit of paying for such a comprehensive range of services. In the medium-term, continued donor support will be necessary to continue providing services to these smaller companies while firms slowly introduce fees and build a record of accomplishment for the services provided.

We continued provide training to local professional personnel and local consultants to improve their expertise and ability to continue providing these services at the conclusion of our program. Training for local professional personnel and consultants focused on business planning, financial management, and marketing.

Trade Facilitation and Linkages Lessons

Facilitating trade linkages for clients was a complex challenge for two primary reasons. First, there was limited information available to SMEs about trade opportunities. Second, many SME clients did not traditionally export and did not have the in-house skills available to conduct market research, to prepare export pricing and quotes, or to research the lowest cost freight forwarders, insurance agencies, and transport companies.

We noted an increased demand for trade related services towards the end of the Program as companies continued to search for export markets due to the liquidity problem in the local economy. Many companies were also beginning to revive former contacts in the Southeast Europe region. Based on our experience with clients at the end of the program, this service has the most potential for generating fees for local advisory and business support programs.